

NEW ENGLAND GAS COMPANY

DISTRIBUTION ADJUSTMENT CLAUSE FILING

RIPUC DOCKET NO. 3548

**BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION**

**TESTIMONY AND EXHIBITS
OF DAVID J. EFFRON**

ON BEHALF OF THE

**DIVISION OF
PUBLIC UTILITIES AND CARRIERS**

OCTOBER 7, 2003

RIPUC DOCKET NO. 3548
DIRECT TESTIMONY
OF DAVID J. EFFRON

TABLE OF CONTENTS

	<u>Page</u>
I. STATEMENT OF QUALIFICATIONS	1
II. PURPOSE AND SUMMARY OF TESTIMONY	2
III. ESM CALCULATION	4

1 **I. STATEMENT OF QUALIFICATIONS**

2 Q. Please state your name and business address.

3 A. My name is David J. Effron. My business address is 386 Main Street, Ridgefield,
4 Connecticut.

5

6 Q. What is your present occupation?

7 A. I am a consultant specializing in utility regulation.

8

9 Q. Please summarize your professional experience.

10 A. My professional career includes over twenty years as a regulatory consultant, two years
11 as a supervisor of capital investment analysis and controls at Gulf & Western Industries
12 and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified
13 Public Accountant and I have served as an instructor in the business program at
14 Western Connecticut State College.

15

16 Q. What experience do you have in the area of utility rate setting proceedings?

17 A. I have analyzed numerous electric, telephone, gas and water rate filings in different
18 jurisdictions. Pursuant to those analyses I have prepared testimony, assisted attorneys
19 in rate case preparation, and provided assistance during settlement negotiations with
20 various utility companies.

21 I have testified in over two hundred cases before regulatory commissions in
22 Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky,

1 Maryland, Massachusetts, Missouri, New Jersey, New York, North Dakota, Ohio,
2 Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, and Virginia.

3

4 Q. Please describe your other work experience.

5 A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was
6 responsible for reports and analyses concerning capital spending programs, including
7 project analysis, formulation of capital budgets, establishment of accounting
8 procedures, monitoring capital spending and administration of the leasing program. At
9 Touche Ross & Co., I was an associate consultant in management services for one year
10 and a staff auditor for one year.

11

12 Q. Have you earned any distinctions as a Certified Public Accountant?

13 A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest
14 scores in the May 1974 certified public accounting examination in New York State.

15

16 Q. Please describe your educational background.

17 A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College
18 and a Masters of Business Administration Degree from Columbia University

19

20 **II. PURPOSE AND SUMMARY OF TESTIMONY**

21 Q. On whose behalf are you testifying?

22 A. I am testifying on behalf of the Rhode Island Division of Public Utilities and Carriers
23 ("the Division").

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Q. What is the purpose of your testimony?

A. On September 2, 2003, New England Gas Company (“NEG” or “the Company”) filed its calculation of the Earnings Sharing Factor pursuant to the Commission’s approval of the incentive based Earnings Sharing Mechanism (“ESM”) contained in the Settlement Agreement in Docket 3401 (“Settlement”). The ESM Factor will be included in the Distribution Adjustment Clause (“DAC”) effective November 1, 2003. The purpose of this testimony is to address the development of the ESM Factor to be included in the DAC. However, as I state below, there are still requests for information outstanding at the time of the preparation of this testimony; therefore, the calculations of earned return on equity and the ESM factor that I am presenting at this time are not final.

Q. Please summarize your testimony.

A. Based on the limited information provided at the time of the preparation of this testimony, I have calculated that for the twelve months ended June 30, 2003, NEG earned \$4,591,000 of excess revenue to be credited to the DAC. There are still information requests outstanding at the time of the preparation of this testimony. Based on the responses to the outstanding information requests, the amount of the calculated over-earnings will change. Therefore, I will modify my quantification of over-earnings based on the responses to those outstanding information requests.

1 **III. ESM CALCULATION**

2 Q. Please describe the ESM Factor of the DAC.

3 A. The Settlement established a mechanism for sharing any annual earnings in excess
4 of 11.25% for the period July 1, 2002 through June 30, 2005 between customers
5 and investors. In particular, Section II.F.5 of the Settlement specifies that:

6 Any annual earnings over 11.25%, up to and including 100 basis
7 points, shall be shared 50% to customers and 50% to the Company.
8 Any earnings in excess of 12.25% shall be shared 75% to
9 customers and 25% to the Company. In calculating the earnings
10 subject to the ESM on an annual basis, the benchmark will remain
11 at 11.25%, unless modified in a subsequent proceeding setting base
12 rates to be effective on or after July 1, 2005. The customer share of
13 any excess earnings will be passed through as a credit to the DAC.
14

15 Q. Did the Settlement specify how the return on equity should be calculated for the
16 purpose of determining whether there were excess earnings to be credited to the
17 DAC?

18 A. Yes. Section II.F.1 of the Settlement states:

19 The return on common equity will be calculated by dividing the net
20 income available for common equity by the common equity
21 applicable to rate base; where the net income available for common
22 equity is equal to operating income adjusted to reflect Commission
23 ratemaking principles less applicable interest and preferred
24 dividends (if any) ...
25

26 Q. Has the Company prepared an analysis of its earned return on common equity for
27 the twelve months ended June 30, 2003 (“FY2003”)?

28 A. Yes. The Company calculated that earned a return on common equity of 15.08% in
29 FY2003, resulting in a refund to customers of \$4,482,000.

30

1 Q. Have you examined the analysis conducted by the Company?

2 A. Yes. I have reviewed the return on common equity ("ROE) presented by the
3 Company in Attachment RJR-1 to the direct testimony of Mr. Riccitelli. My
4 examination included an analysis of the Company's financial statements for the
5 twelve months ended June 30, 2003, workpapers supporting the return on equity
6 calculation, and responses to requests for information by the Division.

7

8 Q. Based on your examination, should the Company's calculation of its earned ROE
9 for FY2003 be modified?

10 A. Yes. There should be certain modifications to the Company's calculation of the
11 earned return on common equity. However, at this time, I am presenting the effect
12 of only one modification, which affects the common equity supporting the utility
13 rate base, the denominator used in the calculation of the earned ROE. Other
14 potential adjustments still being investigated that could further affect the common
15 equity supporting the utility rate base and also the determination of net income, the
16 numerator in the ROE calculation.

17

18 Q. Have you recalculated the earned return on equity with your proposed
19 modification?

20 A. Yes. My calculation of the return on common equity earned by NEG in FY2003 is
21 summarized on Schedule DJE-2.

22

23 Q. Please explain Schedule DJE-2.

1 A. On Schedules DJE-2, Page 1, I have begun in the first column with the net income
2 available for common equity as calculated by the Company. In the next column, I
3 show my proposed adjustments; and in the third column, I show my calculation of
4 the net income available for common equity. At this time, the only adjustments to
5 the Company's calculation of net income available for common equity are the
6 adjustments to interest, preferred dividends, and income taxes that are related to the
7 rate base adjustment shown on Schedule DJE-2, Page 3.

8

9 Q. What net income for available for common equity have you calculated?

10 A. Based on the information provided to date, I have calculated net income available
11 for common equity of \$16,799,000 (Schedule DJE-2, Page 1) for FY2003. This is
12 the amount that should be divided by the balance of common equity to determine
13 the earned return on equity.

14

15 Q. Does the Settlement specify how the balance of common equity used in the
16 earned return calculation should be determined?

17 A. Yes. Section II.F.1 of the Settlement states that in determining the earned return
18 on equity:

19 The common equity applicable to rate base shall be calculated by
20 multiplying the actual common equity ratio, subject to the
21 limitations in paragraph 2 below, by rate base. The rate base used
22 in these calculations will be the average rate base for the relevant
23 period, based on a five-quarter average and established
24 Commission ratemaking principles.
25

1 Paragraph II.F.2 referred to in that section specifies that a common equity
2 ratio of 43.6% will be used to calculate the common equity applicable to rate base
3 during the Rate-Freeze period, July 1, 2002 – June 30, 2005.

4

5 Q. Are you proposing any adjustments to the rate base calculated by the Company
6 for the purpose of determining the common equity balance to be used in the return
7 on common equity calculation?

8 A. Yes. In response to Division Data Request 1-14, the Company acknowledged that
9 the balance of prepayments included in rate base was overstated. I have reduced
10 the balance of prepayments by \$1,227,000 to correct this overstatement (Schedule
11 DJE-2, Page 3).

12

13 Q. With the above changes to the net income available for common equity and the
14 balance of common equity, what return on equity have you calculated for
15 FY2003?

16 A. With the modifications described above, I have calculated that NEG Gas earned a
17 15.18% return on common equity in FY 2003 (Schedule DJE-1).

18

19 Q. Have you also calculated the excess revenue based on this earned ROE?

20 A. Yes, I have calculated excess revenue of \$4,591,000,000 on Schedule DJE-1. This
21 calculation is in the same format as Appendix C to the Settlement.

22

1 Q. Have you also calculated what the ESM Factor to be included in the DAC would
2 be based on this level of excess earnings?

3 A. Yes. Based on sales of 348,924,990 therms, the ESM Factor included in the DAC
4 would be \$0.0132 per therm (Schedule DJE-1).

5

6 Q. Does this conclude your direct testimony?

7 A. This concludes my direct testimony for now. I will supplement this direct
8 testimony after I have received and reviewed the outstanding requests for
9 information.

10

NEW ENGLAND GAS COMPANY
CALCULATION OF EARNINGS SHARING
(\$000)

1	Net Income Available for Common Equity	\$ 16,799
2	Common Equity Supporting Rate Base	<u>110,684</u>
3	Earned Return on Common Equity	15.18%
4	Benchmark Return on Common Equity	<u>11.25%</u>
5	Return on Equity above Benchmark	3.93%
6	Earnings above Benchmark	4,348
7	Company Share of Earnings above Benchmark - 50/50 Sharing	553
8	Company Share of Earnings above Benchmark - 75/25 Sharing	<u>810</u>
9	Ratepayer Share of Earnings above Benchmark	2,984
10	Revenue to be Refunded	\$ 4,591
11	Firm Throughput (000 Therms)	<u>348,925</u>
12	Earnings Sharing Factor (\$/therm)	<u>\$ 0.0132</u>

Line Notes

1	Net Income Available for Common Equity		DJE-2, Page 1
2	Rate Base	\$253,862	DJE-2, Page 3
	Common Equity Ratio	<u>43.60%</u>	DJE-2, Page 4
	Common Equity Supporting Rate Base	<u>\$110,684</u>	
3	Line 1 / Line 2		
4	Per Settlement		
5	Line 3 - Line 4		
6	Line 5 * Line 2		
7	Line 5 (up to 1.00%) * Line 2 / 2, not Less than Zero		
8	((Line 5 - 1.00%)*Line 2)/4, not Less than Zero		
9	Line 6 - Line 7 - Line 8		
10	Line 9 /.65 (1- Tax Rate)		
11	Revised Attachment PCC-7		

12 Line 10 / Line 11